

IT 96-12
Tax Type: INCOME TAX
Issue: Non-filer (Income Tax)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE)
OF THE STATE OF ILLINOIS)

v.

No.

TAXPAYER,

C. Ladewig
Admin. Law Judge

Taxpayer

RECOMMENDATION FOR DISPOSITION

Appearances: ATTORNEY, FOR THE TAXPAYERS, TAXPAYERS.

Synopsis:

THIS MATTER COMES ON FOR HEARING PURSUANT TO THE TAXPAYER'S TIMELY PROTEST OF A NOTICE OF DEFICIENCY ISSUED BY THE ILLINOIS DEPARTMENT OF REVENUE (HEREINAFTER REFERRED TO AS THE "DEPARTMENT") ON SEPTEMBER 25, 1992. AS A RESULT OF A 1991 SALES TAX AUDIT, TAXPAYERS (HEREINAFTER REFERRED TO AS THE "TAXPAYERS") LEARNED THAT THE DEPARTMENT HAD NOT RECEIVED THEIR 1987 IL1040 OR THEIR 1987 FOURTH QUARTER ESTIMATED TAX PAYMENT. TAXPAYERS PAID THE TAX AND INTEREST DUE BUT ARE REQUESTING AN ABATEMENT OF PENALTIES. AT ISSUE IS WHETHER PENALTIES UNDER SECTION 1001 AND 1005 OF THE ILLINOIS INCOME TAX ACT SHOULD BE ABATED DUE TO THE EXISTENCE OF REASONABLE CAUSE. A HEARING WAS HELD ON MARCH 29, 1995.

UPON CONSIDERATION OF ALL THE EVIDENCE, IT IS RECOMMENDED THAT THIS MATTER BE RESOLVED IN FAVOR OF THE TAXPAYERS, TAXPAYERS IN REGARDS TO THE SECTION 1001 PENALTY AND IN FAVOR OF THE DEPARTMENT AS TO THE SECTION 1005 PENALTY.

Findings of Fact:

1. THE DEPARTMENT'S PRIMA FACIE CASE WAS ESTABLISHED WITH THE INTRODUCTION INTO EVIDENCE OF THE NOTICE OF DEFICIENCY DATED SEPTEMBER 25, 1992. DEPT. EX. NO. 1.

2. PENALTIES WERE ASSESSED UNDER SECTION 1001 AND 1005 OF THE ILLINOIS INCOME TAX ACT (IITA) FOR FAILURE TO FILE INCOME TAX RETURNS AND FOR THE UNDERPAYMENT OF TAX. DEPT. EX. NO. 1.

3. TAXPAYERS HAVE PAID THE TAX LIABILITY. TR. P. 2.

4. IN SEPTEMBER, 1987 TAXPAYERS SOLD THEIR ENTIRE INTEREST IN COMPANY (HEREINAFTER REFERRED TO AS "COMPANY"). TR. P. 5.

5. MONIES RECEIVED FROM THE SALE WERE PLACED IN SIX BANK ACCOUNTS. TR. P. 6. TWO OF THESE ACCOUNTS, BANK ACCOUNTS NOS. XXXXX AND XXXXX, CONVERTED FROM CERTIFICATES OF DEPOSIT INTO MONEY MARKET ACCOUNTS IN APRIL, 1988. TR. PP. 8, 9; TAXPAYER EX. NO. 3, 4.

6. PARTNER, A PARTNER IN THE ACCOUNTING FIRM OF ACCOUNTING FIRM, ADVISED THE TAXPAYERS THAT IT WOULD BE PRUDENT TO MAKE A 1987 FOURTH QUARTER ESTIMATED TAX PAYMENT TO THE DEPARTMENT. TR. P. 36. PARTNER OR ONE OF HIS ASSOCIATES PREPARED THE FOURTH QUARTER 1987 ESTIMATED TAX VOUCHER (HEREINAFTER CALLED "VOUCHER"). TR. P. 11; TAXPAYER EX. NO. 8.

7. WITNESS, ALSO OF ACCOUNTING FIRM, WROTE THE TAXPAYERS ON DECEMBER 16, 1987. HE INCLUDED THE PREPARED VOUCHER, ADVISED THEM TO

ATTACH A CHECK FOR \$25,000 AND MAIL IT DIRECTLY TO THE DEPARTMENT. TR. PP. 12, 13; TAXPAYER EX. NO. 7, 8.

8. THE VOUCHER WAS SENT TO THE TAXPAYERS IN SUFFICIENT TIME FOR IT TO BE TIMELY FILED. TR. P. 35.

9. TAXPAYER DOES NOT REMEMBER IF HE WAS SUPPOSED TO WRITE THE \$25,000.00 CHECK OR WHETHER HE ASKED TAXPAYER TO HANDLE THE MATTER. TR. P. 13.

10. TAXPAYER DOES NOT REMEMBER THE CIRCUMSTANCES CONCERNING THE VOUCHER. TR. P. 32.

11. ALTHOUGH TAXPAYER, ON OCCASION, MADE SMALL PAYMENTS TO THE IRS, LARGE PAYMENTS WERE MADE BY TAXPAYER. TR. P. 34.

12. THE DEPARTMENT NEVER RECEIVED THE \$25,000 1987 FOURTH QUARTER ESTIMATED TAX PAYMENT FROM THE TAXPAYERS. DEPT. EX. NO. 1.

13. TAXPAYERS LEARNED THAT THEIR VOUCHER AND PAYMENT CHECK HAD NOT BEEN RECEIVED BY THE DEPARTMENT AS A RESULT OF A 1991 SALES TAX AUDIT ON COMPANY. TR. P. 15.

14. TAXPAYERS REQUIRED DOCUMENTATION FROM THE SALE OF COMPANY (AN S-CORP) TO COMPLETE THEIR 1987 IL-1040 (HEREINAFTER REFERRED TO AS THE "RETURN"). TR. P. 15. AS OF APRIL 15, 1988, THE TAXPAYERS HAD NOT RECEIVED ALL PAPERWORK AND THEREFORE, FILED AN APPLICATION FOR EXTENSION OF TIME TO FILE FORM IL-1040. TR. P. 15; TAXPAYER EX. NO. 9. THIS 1987 EXTENSION FORM IL505-I (HEREINAFTER CALLED "EXTENSION"), WAS FILED ON APRIL 11, 1988. TR. PP. 15-17.

15. THE EXTENSION SHOWED AN AMOUNT DUE OF \$8,500.00 (TR. P. 16; TAXPAYER EX. NO. 9) WITH TAXPAYER PRODUCING A PHOTOSTATIC COPY OF A CHECK PAYING THE \$8,500 DATED APRIL 14, 1988. TAXPAYER EX. NO. 13.

16. TAXPAYER MAINTAINED PHOTOSTATIC COPIES OF CHECKS TO PAY THE FOLLOWING: FEDERAL 1987 INDIVIDUAL INCOME TAXES, A FIRST QUARTER 1988 ESTIMATED FEDERAL PAYMENT, AND A 1988 FIRST QUARTER ILLINOIS ESTIMATED INCOME TAX PAYMENT. TR. PP. 20, 21; TAXPAYER EX. NO. 13.

17. TAXPAYER MADE PHOTOSTATIC COPIES OF THESE CHECKS AT THE TIME OF PAYMENT IN ORDER TO KEEP TRACK OF PAYMENTS. TR. P. 21.

18. WITNESS PREPARED TAXPAYERS 1987 IL-1040 TAX RETURN ON OR BEFORE JUNE 8, 1988. TAXPAYER EX. NO. 15.

19. TAXPAYERS SIGNED THEIR 1987 ILLINOIS TAX RETURN ON JULY 25, 1988. TAXPAYER EX. NO. 14. THE RETURN WAS DUE ON OR BEFORE AUGUST 15, 1988 GIVEN THE EXTENSION. TAXPAYER EX. NO. 9.

20. IN MOST CASES TAXPAYERS' ACCOUNTING FIRM PROVIDED A PRE-ADDRESSED ENVELOPE AND TAXPAYER BROUGHT THE MAIL ITEM TO THE COMPANY MAIL ROOM WHERE ONE OF THE COMPANY CLERKS MAILED IT OUT WITH ORDINARY MAIL. TR. P. 22.

21. TAXPAYER GAVE THE 1987 ILLINOIS AND FEDERAL TAX RETURNS TO THE COMPANY MAILROOM. TR. P. 23.

22. TAXPAYER HAD PREVIOUSLY USED THE COMPANY MAILROOM TO MAIL BUSINESS AND PERSONAL LETTERS. TR. P. 22.

23. TAXPAYER WAS NOT EXPECTING A REFUND CHECK FOR 1987, RATHER THE REFUND WAS TO BE APPLIED TO ANY 1988 TAXES DUE. TR. P. 23.

24. TAXPAYERS DID NOT DISCOVER THAT THE 1987 IL-1040 HAD NOT BEEN RECEIVED BY THE DEPARTMENT UNTIL TAXPAYER'S BUSINESS, COMPANY, WAS AUDITED IN 1991. TR. P. 33.

25. THE DEPARTMENT NEVER RECEIVED TAXPAYERS' 1987 IL 1040 RETURN. DEPT. EX. NO. 1.

Conclusions of Law:

UNDER THE ILLINOIS INCOME TAX ACT, PERSONS WHO INCUR TAX LIABILITY ARE REQUIRED TO FILE RETURNS. 35 ILCS 5/502. SUCH FILING AND PAYMENT OF TAXES IS REQUIRED IN A TIMELY MANNER, INCLUDING ESTIMATED TAX PAYMENTS. 35 ILCS 5/803.

PENALTIES ARE IMPOSED BY THE DEPARTMENT FOR FAILURE TO COMPLY WITH THESE SECTIONS. PRIOR TO JANUARY 1, 1994¹ SECTION 1001 OF THE ILLINOIS INCOME TAX ACT PROVIDED, IN RELEVANT PART:

FAILURE TO FILE TAX RETURNS. IN CASE OF FAILURE TO FILE ANY TAX RETURN REQUIRED UNDER THIS ACT ON THE DATE PRESCRIBED THEREFOR, (DETERMINED WITH REGARD TO ANY EXTENSIONS OF TIME FOR FILING), UNLESS IT IS SHOWN THAT SUCH FAILURE IS DUE TO REASONABLE CAUSE, THERE SHALL BE ADDED AS A PENALTY TO THE AMOUNT REQUIRED TO BE SHOWN AS TAX

35 ILCS 5/1001.

GUIDANCE AS TO WHAT IS NECESSARY TO ESTABLISH THE REQUISITE REASONABLE CAUSE IS FOUND IN THE FEDERAL INCOME TAX REGULATION SECTION 301.6651-1(C)(1)(1991).¹ THIS SECTION PROVIDES THAT "IF THE TAXPAYER EXERCISED ORDINARY BUSINESS CARE AND PRUDENCE AND WAS NEVERTHELESS UNABLE TO FILE THE RETURN WITHIN THE PRESCRIBED TIME, THEN THE DELAY IS DUE TO A REASONABLE CAUSE." TREAS. REG. SECTION 301.6651-1(C)(1)(1991). CASE LAW ALSO PROVIDES THAT "REASONABLE CAUSE MEANS NOTHING MORE THAN THE EXERCISE OF ORDINARY BUSINESS CARE AND PRUDENCE." HAYWOOD LUMBER & MINING CO. V. COMMISSIONER, 162 F.2D 769 (2ND CIR. 1950).

¹ As of January 1, 1994, Section 1001 penalties are provided for under the Uniform Penalty and Interest Act. See, 35 ILCS 735/3-1 *et seq.*

¹ During the taxable period in question the Department's regulations used the Federal Income Tax reasonable cause guidelines. See, 86 Admin. Code Ch. 1, Sec. 130.901. As of January 1, 1994 Department regulations provide further guidance in the determination of reasonable cause. See, 86 Admin. Code Ch. 1, Sec. 700.400.

IN LEVINE V. COMMISSIONER, 22 TCM 1164 (CCH) (1963), THE COURT FOUND REASONABLE CAUSE WHERE A TAXPAYER HAD RELIED ON AN OFFICE PROCEDURE WHICH HAD RESULTED IN THE SUCCESSFUL FILING OF HIS RETURN FOR MANY YEARS. PENALTIES HAD NEVER BEEN ESTABLISHED WHERE THE RETURN HAD BEEN FILED IN THIS MANNER. DURING THE PARTICULAR YEAR IN QUESTION, HOWEVER, A SLIP-UP IN OFFICE PROCEDURE RESULTED IN THE LATE FILING OF THE RETURN.

IN THE PRESENT CASE, TAXPAYER TESTIFIED THAT HE HAD PREVIOUSLY RELIED ON COMPANY'S MAILROOM TO MAIL BOTH PERSONAL AND BUSINESS CORRESPONDENCE. TR. PP. 22, 23. TAXPAYER HAD NO REASON TO DOUBT THAT THIS PROCEDURE WOULD RESULT IN THE TIMELY FILING OF HIS TAX RETURN. TR. P. 23. TAXPAYER'S ACCOUNTANT, PARTNER, TESTIFIED THAT HIS FIRM DELIVERED THE RETURN TO TAXPAYERS IN JUNE OF 1988, IN SUFFICIENT TIME TO ALLOW FOR TIMELY FILING GIVEN THE FILING EXTENSION. TR. P. 38. IT WAS TAXPAYERS' USUAL PRACTICE TO HAVE PARTNER PREPARE THE RETURN, WHEREAS, TAXPAYERS WOULD THEN SIGN AND MAIL IT SOON THEREAFTER. TR. P. 22. IN THIS CASE, TAXPAYER'S RELIANCE UPON A PROCEDURE WHICH HAD PREVIOUSLY RESULTED IN THE SUCCESSFUL MAILING OF BOTH BUSINESS AND PERSONAL CORRESPONDENCE CONSTITUTES ORDINARY BUSINESS CARE AND PRUDENCE. SEE, OPPENHEIMER V. COM'R, 16 T.C. 515 (1951). (THE COURT ALLOWED TAXPAYER TO OFFER PROOF OF RELIANCE ON HER USUAL CUSTOM OR PRACTICE OF PREPARING AND FILING HER RETURNS TO ESTABLISH TIMELY FILING OF THE RETURN IN CONTROVERSY.)

CONSIDERATION CAN ALSO BE GIVEN TO TAXPAYERS' FILING RECORD IN DETERMINING IF TAXPAYER EXERCISED ORDINARY BUSINESS CARE AND PRUDENCE. TAXPAYER AND HIS ACCOUNTANT BOTH TESTIFIED THAT PRIOR TO AND SUBSEQUENT TO THE TAXABLE YEAR IN CONTROVERSY TAXPAYER HAD ALWAYS FILED TIMELY. TR. PP. 33, 40.

GIVEN THE FACTS REGARDING THE FILING OF THE 1987 IL-1040, IT HAS BEEN DETERMINED THAT TAXPAYER DID ALL THAT ORDINARY BUSINESS CARE AND PRUDENCE COULD REASONABLY DEMAND.

PENALTIES WERE ALSO ASSESSED UNDER SECTION 1005. PRIOR TO JANUARY 1, 1994², SECTION 1005 OF THE ILLINOIS INCOME TAX ACT PROVIDES IN PART:

IF ANY AMOUNT OF TAX REQUIRED TO BE SHOWN ON A RETURN PRESCRIBED BY THIS ACT IS NOT PAID ON OR BEFORE THE DATE REQUIRED FOR FILING SUCH RETURN (DETERMINED WITHOUT REGARD TO ANY EXTENSION OF TIME TO FILE), A PENALTY SHALL BE IMPOSED AT THE RATE OF 6% PER ANNUM UPON THE TAX UNDERPAYMENT UNLESS IT IS SHOWN THAT SUCH FAILURE IS DUE TO REASONABLE CAUSE

35 ILCS 5/1005.

TO AVOID THE IMPOSITION OF THE SECTION 1005 PENALTY UNDER THE IITA, A TAXPAYER MUST AFFIRMATIVELY PUT FORTH EVIDENCE WHICH ESTABLISHES THAT HE EXERCISED ORDINARY BUSINESS CARE AND PRUDENCE. SEE TREAS. REG. SECTION 301.6651-1(C). ORDINARY BUSINESS CARE AND PRUDENCE IS DETERMINED BY EXAMINING ALL OF THE FACTS AND CIRCUMSTANCES IN A PARTICULAR CASE.

IN THE PRESENT CASE, TAXPAYER DEPOSITED THE \$1.2 MILLION PROCEEDS FROM THE SALE OF THE COMPANY INTO SIX DIFFERENT BANK ACCOUNTS. THESE ACCOUNTS INCLUDED SAVINGS, REGULAR CHECKING AND MONEY MARKET ACCOUNTS. TR. PP. 5-10. EACH SPOUSE TESTIFIED THAT THEY RELIED ON THE OTHER TO TAKE CARE OF THE LARGE OBLIGATION TO THE DEPARTMENT. HOWEVER, UNDER THESE CIRCUMSTANCES, ORDINARY BUSINESS CARE AND PRUDENCE WOULD DEMAND THAT A TAXPAYER PAY CLOSER ATTENTION TO ENSURE THAT THE REMITTANCE WAS MADE TO THE STATE. TAXPAYERS ADMITTED THEY HAD BEEN INFORMED BY THEIR ACCOUNTANT AS TO THE AMOUNT AND DUE DATE OF THE LIABILITY. THE RECORD,

² As of January 1, 1994, Section 1005 penalties are provided for under the Uniform Penalty and Interest Act. See, 35 ILCS 735/3-1 *et seq.*

HOWEVER, DOES NOT DISCLOSE ANY EFFORT OR INQUIRY ON THE PART OF EITHER TAXPAYER TO DISCOVER WHETHER THE CHECK HAD BEEN MAILED. BLINDLY ASSUMING THE OTHER SPOUSE HAD FULFILLED A DUTY INCUMBENT ON THEM BOTH IS NOT BEHAVIOR WHICH SATISFIES THE STANDARD PARTICULARLY WHEN NO SET PATTERN OF CONDUCT HAS BEEN ESTABLISHED.

TAXPAYERS TESTIFIED THAT THE MONEY MARKET ACCOUNTS DID NOT PROVIDE ITEMIZED STATEMENTS OR RETURN CANCELLED CHECKS PERMITTING THEM TO ASCERTAIN IN A MORE TIMELY MANNER THAT THE \$25,000 PAYMENT WAS NOT RECEIVED BY THE DEPARTMENT. HOWEVER, AN EXAMINATION OF THE ITEMIZED STATEMENTS IN EVIDENCE DISCLOSES THAT THE STATEMENTS PROVIDED ARE FROM A PERIOD IN WHICH THE ACCOUNT WAS STILL HELD AS A CERTIFICATE OF DEPOSIT WHEREIN STATEMENTS OF ACCOUNT SHOULD NOT BE EXPECTED. STATEMENTS PROVIDED WERE NOT FROM PERIODS AFTER THE CONVERSION FROM CD TO MONEY MARKET ACCOUNT.

THE PROCEEDS FROM THE SALE WERE DEPOSITED IN THEIR ACCOUNTS ON OR ABOUT SEPTEMBER 3, 1987. TR. PP 5-10. THE ACCOUNTANT'S LETTER OF DECEMBER 16, 1987 INDICATED THE VOUCHER SHOULD HAVE BEEN MAILED PRIOR TO DECEMBER 31, 1987 OR AT LEAST BEFORE THE JANUARY 15TH DUE DATE. TAXPAYERS HAD NEARLY THREE MONTHS TO REALIZE THEIR ACCOUNTS WERE NOT PROVIDING ITEMIZED STATEMENTS OR CANCELLED CHECKS. A PERSON EXERCISING THE NECESSARY CARE WOULD NOT WRITE SUCH IMPORTANT CHECKS ON SUCH AN UNUSUAL ACCOUNT.

THIS ASIDE, TAXPAYERS CLAIM THAT THE CONFUSION CAUSED BY MAINTAINING SIX BANK ACCOUNTS CONSTITUTES "REASONABLE CAUSE" FOR AVOIDING THE PENALTY. TAXPAYERS' RELY ON SANDERLING, INC. V. COM'R, 571 F.2D 174 (3RD CIR. 1978) TO SUPPORT THEIR CONTENTION. SANDERLING, HOWEVER, CAN BE DISTINGUISHED FROM THE CASE AT HAND. IN THAT CASE, TAXPAYERS WERE CONFUSED AS TO THE PROPER TAXABLE PERIOD AND THE CORRECT DUE DATE. IN

FACT, THE IRS WAS ALSO UNSURE OF THE PROPER TAXABLE PERIOD AND HAD INITIALLY TAKEN AN INCORRECT POSITION. SANDERLING PRESENTS UNUSUAL CIRCUMSTANCES WHICH DO NOT EXIST IN THE PRESENT CASE. HERE, TAXPAYERS WERE WELL AWARE OF THE TAXABLE PERIOD AND THE PAYMENT DUE DATE. THEIR CONFUSION RELATED TO THEIR OWN BILL PAYMENT METHODS.

ORDINARY BUSINESS CARE AND PRUDENCE DEMANDS THAT A TAXPAYER EITHER USE AN ACCOUNT WHERE SUFFICIENT DOCUMENTATION WAS PROVIDED OR DOCUMENT THE TRANSACTION THEMSELVES. IN FACT, TAXPAYERS PRODUCED PHOTOSTATIC COPIES OF OTHER BILLS THEY HAD PAID TO THE DEPARTMENT AND INTERNAL REVENUE SERVICE INDICATING A REALIZATION OF THEIR DUTY TO KEEP SUFFICIENT RECORDS. THUS, THE TAXPAYERS' FAILURE TO KEEP RECORDS IN THIS INSTANCE DOES NOT ABSOLVE THEM OF PENALTIES WHEN THEY KEPT PROPER RECORDS FOR OTHER BILL PAYMENTS. THEY HAD NO CONFUSION WHEN IT CAME TO KEEPING RECORDS OF PAYMENTS TO THE IRS AND TO OTHER ENTITIES.

TAXPAYERS HAVE ESTABLISHED THAT THEIR FAILURE TO FILE THE 1987 IL-1040 WAS DUE TO REASONABLE CAUSE AND THEREFORE, ARE ENTITLED TO AN ABATEMENT OF THE SECTION 1001 PENALTY. THE SECTION 1005 PENALTY SHOULD NOT BE ABATED, HOWEVER, BECAUSE TAXPAYERS FAILED TO EXERCISE ORDINARY BUSINESS CARE AND PRUDENCE IN ATTEMPTING TO PAY THEIR 1987 FOURTH QUARTER ESTIMATED TAX.

WHEREFORE, FOR THE REASONS STATED ABOVE, IT IS MY RECOMMENDATION THAT THE NOTICE OF DEFICIENCY BE FINALIZED, AS MODIFIED BY THE ABATEMENT OF THE SECTION 1001 PENALTY.

CHRISTINE E. LADEWIG
ADMINISTRATIVE LAW JUDGE